

GOVERNMENTAL AFFAIRS
OFFICE

DIRECTOR
Robert D. Evans
(202) 662-1765
rdevans@staff.abanet.org

SENIOR LEGISLATIVE COUNSEL
Denise A. Cardman
(202) 662-1761
cardmand@staff.abanet.org

Kevin J. Driscoll
(202) 662-1766
driscollk@staff.abanet.org

Lillian B. Gaskin
(202) 662-1768
gaskinl@staff.abanet.org

LEGISLATIVE COUNSEL
R. Larson Frisby
(202) 662-1098
frisbyr@staff.abanet.org

Kristi Gaines
(202) 662-1763
gainesk@staff.abanet.org

Mondi Kumbula-Fraser
(202) 662-1789
kumbulam@staff.abanet.org

Ellen McBarnette
(202) 662-1767
mcbarnee@staff.abanet.org

E. Bruce Nicholson
(202) 662-1769
nicholsonb@staff.abanet.org

DIRECTOR GRASSROOTS
OPERATIONS
Julie M. Strandlie
(202) 662-1764
strandlj@staff.abanet.org

INTELLECTUAL PROPERTY
LAW CONSULTANT
Hayden Gregory
(202) 662-1772
gregoryh@staff.abanet.org

STAFF DIRECTOR FOR
STATE LEGISLATION
Kenneth Goldsmith
(202) 662-1780
goldsmithk@staff.abanet.org

STAFF DIRECTOR FOR
INFORMATION SERVICES
Sharon Greene
(202) 662-1014
greenes@staff.abanet.org

EDITOR WASHINGTON LETTER
Rhonda J. McMillion
(202) 662-1017
mcmillionr@staff.abanet.org

May 10, 2004

VIA FACSIMILE

The Honorable F. James Sensenbrenner, Jr.
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Re: Full Committee Markup of H.R. 2179, the "Securities Fraud Deterrence and Investor Restitution Act of 2003," Scheduled for May 12, 2004

Dear Mr. Chairman:

On behalf of the American Bar Association ("ABA") and its more than 400,000 members throughout the country, I write to express our concerns regarding several provisions contained in H.R. 2179, the "Securities Fraud Deterrence and Investor Restitution Act of 2003," that would significantly reduce the due process rights of individuals and companies accused of violating the federal securities laws. As you and your colleagues prepare for the full committee markup of the legislation, currently scheduled for May 12, 2004, the ABA respectfully urges you to delete these provisions from the bill.

H.R. 2179 would grant the Securities and Exchange Commission ("SEC") new authority to levy civil monetary penalties in administrative proceedings against any individual or company alleged to have violated (or to have caused someone else to violate) any federal securities law or regulation. Currently the SEC can do this only against individuals and companies in the securities industry, such as broker-dealers, investment companies or investment advisors. For non-regulated persons, the SEC currently can only seek civil monetary penalties in federal court, where defendants have a right to a jury trial. The legislation would also authorize the SEC to subpoena financial and other records without first providing notice to the subject of the request. Under present law, federal court approval is required for the SEC to subpoena records without such notice.

May 10, 2004

Page 2

The purpose of these and other provisions in H.R. 2179 is to strengthen the SEC's enforcement authority. The ABA supports vigorous and effective enforcement of the securities laws to protect investors and the public interest. Towards that end, the ABA recently has gone on record in support of legislation to fully fund the SEC's enforcement efforts. The ABA also recognizes the need to restore a culture of integrity and confidence in our financial, business and professional institutions that will warrant the trust of the American public. In addition, the ABA strongly believes that lawyers have an important role in assisting clients to comply with the law and meet high standards of ethical and responsible conduct. The ABA's commitment to these core principles is evidenced by the recently issued report of its Task Force on Corporate Responsibility that calls for a number of specific corporate governance reforms designed to protect the investing public. The ABA Task Force report is available online at the following web address: http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf.

Although the ABA supports vigorous enforcement of the securities laws, we believe that any new enforcement measures must protect the fundamental rights of those accused, including the right to due process, to trial by jury and to effective representation of counsel. Moreover, such measures should not erode the important role that federal courts play in protecting the rights of all Americans by shifting the courts' powers to administrative agencies that are not bound by the same safeguards. Unfortunately, the provisions in H.R. 2179 that would grant the SEC sweeping new powers to impose fines and subpoena documents do not meet these standards.

The provisions in H.R. 2179 that would grant the SEC new administrative powers to subpoena documents without notice and to assess multi-million dollar civil monetary penalties without first obtaining a court judgment would severely weaken important due process protections and privacy rights of the accused. Under current law, if the SEC believes that a non-regulated party (i.e., someone other than a broker-dealer, an investment company or an investment advisor) has violated the securities laws, it must prove its case in federal court before a fine can be imposed. When the SEC files suit in federal court, the company or individual accused of wrongdoing has all of the appropriate due process rights enjoyed by defendants in other types of cases, including the right to examine relevant documents, to examine and cross-examine witnesses, and to have an impartial federal judge or jury decide the case. In addition, federal court trials are subject to the well-established, objective procedural rules contained in the Federal Rules of Evidence and the Federal Rules of Civil Procedure. SEC administrative hearings, on the other hand, do not guarantee these fundamental due process rights.

The legislation would also weaken important due process protections in the appeals process. Appeals from SEC administrative proceedings are referred to the SEC Commissioners for review, but this does not ensure the same protection as judicial review, especially since it is the SEC Commissioners themselves who voted to authorize the case in the first instance. Although final SEC decisions are ultimately reviewable by the federal court of appeals, a party must first go through the lengthy, time-consuming and expensive process of completing an administrative hearing and an appeal to the Commissioners. Once the matter reaches the federal court of appeals, moreover, the court will only review the matter on a very deferential "substantial evidence" standard. See 5 U.S.C. § 706(2)(E).

May 10, 2004

No evidence has been put forward to show that the SEC needs the authority to subpoena documents without notice or assess civil monetary penalties in administrative proceedings without court approval. The SEC does not contend that it has had any difficulty in getting courts to waive the usual notice requirement for subpoenas in appropriate circumstances or assess appropriate civil monetary penalties against those accused of violating the securities laws. Furthermore, in those cases in which the SEC has solid evidence against alleged wrongdoers, the Commission has generally been successful in obtaining court judgments and appropriate remedies, including civil monetary penalties. In the absence of a clear showing of a compelling need to place this broad authority in the hands of an administrative agency, eliminating the basic protections afforded defendants in the federal courts is contrary to sound public policy.

In addition to the foregoing policy considerations, the proposal to grant the SEC new administrative powers to impose civil monetary penalties on non-regulated persons also raises important constitutional questions. The Seventh Amendment guarantees the right to a jury trial in civil suits at common law in which legal (i.e., non-equitable) remedies are sought. Civil monetary penalties are among the legal remedies for which a jury trial is required. *See, e.g., Feltner v. Columbia Pictures TV*, 523 U.S. 340 (1998) (right to jury for copyright statutory damages); *Tull v. United States*, 481 U.S. 412 (1987) (right to jury for civil penalties under Clean Water Act). Congress may not evade the Seventh Amendment by assigning legal remedies to a non-Article III tribunal without juries. *Granfinanciera SA v. Nordberg*, 492 U.S. 33 (1989) (right to jury for fraudulent conveyance actions assigned by Congress to non-jury bankruptcy courts).

A line of cases allows Congress to permit administrative agencies to assess civil monetary penalties against regulated entities in cases involving “public rights.” *Atlas Roofing Co. v. OSHA*, 430 U.S. 442 (1977) (permitting OSHA civil monetary penalties in administrative actions). These cases, in turn, provide support for the view that the existing statutory provisions allowing the SEC to assess civil monetary penalties against regulated individuals and entities in the securities industry are constitutional (despite the tension with the Supreme Court’s more recent decision in *Granfinanciera*). However, there is a more serious potential constitutional problem in allowing administrative civil monetary penalties against non-regulated individuals and entities. For example, many such cases would involve the relationship between a company and its shareholders – a set of issues that the Supreme Court has held is subject to Seventh Amendment jury trial rights. *Ross v. Bernhard*, 396 U.S. 531 (1970) (right to jury trial for shareholder derivative suits).

Although the ABA is concerned with the due process and constitutional implications of H.R. 2179 as it would apply to all those accused of violating the federal securities laws, we have special concerns regarding the impact that the bill’s fine and subpoena provisions would have on the attorney-client relationship. In particular, the ABA is very concerned that by granting an administrative agency expanded powers to impose multi-million dollar fines and subpoena documents without notice—especially an agency, like the SEC, before which the lawyer represents his or her client—H.R. 2179 will interfere with the client’s right to effective representation by counsel. Exposing lawyers to enormous civil monetary penalties, without the usual due process protections afforded by a judicial proceeding, will interfere with the critical

May 10, 2004

attorney–client relationship by creating a conflict between the counsel’s need to defend his or her own interests and the counsel’s duty to zealously advocate the client’s position.

For all of these reasons, the ABA believes that the provisions in H.R. 2179 that would grant the SEC new administrative authority to impose civil monetary fines and subpoena financial records without notice would have serious adverse consequences for our nation’s securities law enforcement system. By eroding the fundamental rights of those accused of violating the securities laws, including the right to due process, to trial by jury and to effective representation of counsel—without any showing that these extraordinary powers are even needed by the SEC—these provisions would cause far more harm than good. Accordingly, the ABA respectfully urges you to delete these provisions from H.R. 2179.

Thank you for your consideration. If you have any questions regarding the ABA’s views on these important issues, please ask your staff to contact Larson Frisby, our legislative counsel for business law, at (202) 662-1098.

Sincerely,

A handwritten signature in cursive script that reads "Robert D. Evans".

Robert D. Evans

cc: All members of the House Judiciary Committee (via facsimile)